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IN THE

Supreme Court of the United States

OCTOBER TERM, 1940

No. 466

DONALD N. GILBERT, HAROLD C. YEAGER and GEORGE A. CAREY, constituting the First Mortgage Bondholders' Protective Committee for The Peoria and Eastern Railway Company's First Consolidated Mortgage 4% Bonds due April 1, 1940,

Petitioners,

against

THE PEORIA AND EASTERN RAILWAY COMPANY and WILLIAM CARNEGIE EWEN, LEWIS L. CLARKE and MAURICE D. ADAMS, as the Peoria and Eastern Railway Company Income Bondholders' Protective Committee,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK AND MOTION TO DISPENSE WITH PRINTING AND SERVICE OF PORTIONS OF RECORD AND FOR THE PRINTING OF A JOINT RECORD

DONALD N. GILBERT, HAROLD C. YEAGER and GEORGE A. CAREY, Petitioners,
By SCRIBNER & MILLER,
ALFRED E. SMITH, JR.,
Solicitors of Petitioners.

MARK HYMAN,
Counsel for Petitioners.

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MOTION TO DISPENSE WITH PRINTING AND SERVICE OF PORTIONS OF RECORD AND FOR THE PRINTING OF A JOINT RECORD 44

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

TO THE HONORABLE, THE CHIEF JUSTICE OF THE UNITED STATES AND THE ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

DONALD N. GILBERT, HAROLD C. YEAGER and GEORGE A. CAREY, as a Committee for Peoria & Eastern's First Consolidated Mortgage 4% Bonds, your petitioners above-mentioned, intervened herein pursuant to order of the District Court dated May 8, 1940.

This is an application for a writ of certiorari to review the final decree of the United States District Court for the Southern District of New York, convened as a special court of three judges, which approved and confirmed a plan of railroad adjustment; all pursuant to the Railroad Adjustments Act, being Chapter 15 of the Bankruptcy Act (§§ 700-755, added July 29, 1939).

Jurisdiction

The jurisdiction of the Court to grant the writ of certiorari applied for rests upon § 745 of said chapter (11 U. S. C. A. 1245), reading as follows:

> "Any final order or decree of the special court may be reviewed by the Supreme Court of the United States upon application for certiorari made by any person affected by the plan who deems himself aggrieved within sixty days after the entry of such order or decree, pursuant to the provisions of the Federal Judicial Code."

Opinion Below

The opinion below is annexed hereto as Appendix A.

Statute Involved

The pertinent provisions of the Railroad Adjustments Act (Bankruptcy Act, Chapter 15) are annexed hereto as Appendix B.

The Questions Presented

(a) Whether a twenty-year extension of the mortgage debt is an arrangement, temporary only, for meeting such debt; within the meaning of said Chapter 15.

(b) Whether a junior creditor-stockholder may appropriate future earnings to his debt instead of applying them to meet the matured mortgage debt.

(c) Whether under said Chapter 15 a twenty-year extension of the mortgage debt may be forced without showing that the railroad had even attempted to refinance the debt.

(d) Whether a railroad with inadequate capital and earnings is meeting its debts with only a temporary extension when it forces a twenty-year moratorium with no *interim* part payments.

(e) Whether the Plan is fair and equitable or displaces the legal priority of the mortgage debt over junior creditors and stockholders.

(f) Whether equitable relief against strict foreclosure could be afforded the parent corporation without first determining whether it had diverted or wasted the assets of the completely-dominated subsidiary.

(g) Whether a parent corporation, within the "Instrumentality Rule" can compete with and displace prior lienors.

(h) Whether the overdue mortgage debt was entitled to a sinking fund out of earnings.

(i) Whether accounts which are the product of retired and depreciated rolling stock which is covered by the mortgage should be applied to or for the security of the overdue mortgage debt.

(j) Whether a proper accounting by the parent corporation was a condition precedent to granting it the enormous advantages of the Plan, in view of the charges of diversion and waste of assets.

Summary Statement

The decree below dated July 23, 1940, entered on July 29, 1940, approved and confirmed the "Plan of Adjustment under Chapter 15 of the Bankruptcy Act" of The Peoria and Eastern Railway Company, dated January 10, 1940.

(a) The Railroad and its First Consolidated Mortgage

On February 22, 1890, there was a foreclosure and reorganization of the Ohio, Indiana and Western Railway Company, running from Springfield, Ohio, to Peoria, Illinois, whereunder the Indiana and Illinois Divisions (from Indianapolis, Indiana, to Pekin, Illinois) were deeded to The Peoria and Eastern Railway Company, and whereunder the Springfield Division (from Indianapolis, Indiana, to Springfield, Ohio) was deeded to the Cleveland, Cincinnati, Chicago and St. Louis Railway Company (the "Big Four"), subject to a purchase money lien of $5,000,000 in favor of the mortgage trustee and bondholders hereinafter mentioned (Findings No. 5, 6).

Simultaneously, an Operating Agreement was made for the Peoria & Eastern road with the Big Four, which ever since has owned 50+% of the stock of Peoria & Eastern (Findings No. 9, 16, 17, 51).

Simultaneously, an indenture of mortgage was executed from Peoria & Eastern to Central Trust Company of New York and Charles W. Fairbanks, Trustees, embracing the Indiana and Illinois Divisions and trackage rights into Indianapolis and Peoria, and covering also said $5,000,000 purchase money lien upon the Springfield Division of the Big Four; all in trust for the First Consolidated Mortgage Bondholders of Peoria & Eastern. Of such bonds $8,376,000 are outstanding and publicly owned, and $500,000 are pledged with the Securities Corporation of the New York Central (Findings No. 8, 12, 13, 31).

By January 2, 1930, the New York Central Railroad Company had acquired 96% of the Big Four stock; and on said date acquired the Big Four's rights under the foregoing operating agreement, and also acquired a lease on the Springfield Division and other lines of the Big Four (Findings No. 18, 19). The line of the Peoria & Eastern is part of the main line of the New York Central from the East, and constitutes the entrance of the New York Central into the Peoria gateway, which is "recognized as a major western gateway along with Chicago and St. Louis" (J. A. Keegan, Gen. Freight Agent, N. Y. Central).

Under the aforesaid Operating Agreement, Big Four covenanted to make good any deficiency in operating income necessary to pay the interest on the first mortgage bonds and any prior lien bonds of Peoria & Eastern. Said interest at that time amounted to $412,200 annually. Big Four guaranteed that the net earnings "so actually applied to the payment of said interest shall be not less than $412,200 in each and every year of the fifty years for which it by these presents undertakes the use and occupation of the said * * * railroad". By Paragraph Fifth of the Agreement, Big Four agreed to "look only to such future net earnings * * * as shall not be required for the payment of said interest on said prior bonds and on said first consolidated mortgage bonds, and hereinabove guaranteed by it, for the reimbursement to it of any sums it may advance in compliance with its aforesaid covenants and agreements" (Ex. 26).

(b) Present Status of Peoria & Eastern

On April 1, 1940, the following of Peoria's obligations matured (Finding No. 31):

1. The $846,000 outstanding bonds prior to the First Consolidated Mortgage Bonds.

2. The First Consolidated 4% Mortgage Bonds, aggregating $8,376,000 publicly held which were secured by a mortgage on Peoria & Eastern's railway and by the said $5,000,000 purchase money lien.

3. Its 5% promissory note to the Securities Corporation of the New York Central, secured by $500,000 of its First Consolidated Mortgage Bonds and by its 1,730 shares of capital stock of Peoria & Pekin Union Railway Co.

On April 1, 1940, the aforesaid Operating Agreement expired by its terms (Finding No. 33). New York Central and Big Four claimed that Peoria owed $2,485,482.58 (intercompany debt) advances purportedly made thereunder. Admittedly, New York Central owes Peoria & Eastern $1,290,296.84 held in the equipment retirement and equipment depreciation accounts (Finding No. 29).

Peoria & Eastern's $4,000,000 income mortgage 4% bonds are not due until April 1, 1990. Interest thereon is not payable until after payment has been made of interest on the First Consolidated Mortgage Bonds and of both interest at 6% and principal on the aforesaid intercompany debt (Finding No. 11).

There also matured on April 1, 1940 the First Mortgage Bondholders' aforesaid $5,000,000 purchase money lien on Big Four's Springfield Division (Finding No. 32). While Big Four was not obligated to pay the $5,000,000, its failure so to do constituted a default which gave the bondholders' trustee the right to take possession of the said Springfield Division and to foreclose the mortgage thereon (Finding No. 13). Moreover in 1919, the Big Four covenanted with its own mortgage bondholders to pay said lien (Finding No. 15).

(c) The Plan of Adjustment (Ex. 5)

To meet its maturities, Peoria & Eastern proposed its Plan of Adjustment of January 10, 1940. The Plan is predicated upon payment by the Big Four of $5,000,000 to discharge the said purchase money lien. On April 1, 1940, Big Four paid the said sum by New York Central's check to the Trustee for the First Mortgage Bondholders, conditioned upon the Plan's becoming effective (Ex. 46). The Plan provides for the application of the $5,000,000 as follows:

1. Payment in full of the $846,000 bonds prior to the First Consolidated Mortgage Bonds.
2. Payment of $384,500 to the Securities Corporation of the New York Central on account of Peoria & Eastern's note to it of $500,000, secured by $500,000 of First Consolidated Mortgage Bonds, leaving $115,500 of such bonds.

3. Payment of $3,769,200 on account of the $8,376,000 principal amount of Peoria & Eastern's First Consolidated Mortgage Bonds ($450 for each $1,000 bond), reducing such outstanding bonds to $4,606,800.

4. The remaining $300 is to be used to purchase Peoria & Eastern's First Consolidated Mortgage Bonds at lowest possible prices by the Trustee.

The Plan further provides for:

5. The extension of the maturity of the remaining $4,722,300 First Consolidated Mortgage Bonds to April 1, 1960 at 4% per annum without any amortization or sinking fund. Peoria & Eastern is to pledge as additional security for these extended bonds its 1,730 shares of Peoria & Pekin Union Railway Co. capital stock.

6. The Operating Agreement is to be purportedly extended to April 1, 1960, and the intercompany debt aggregating with interest $2,506,192 allegedly owed by Peoria & Eastern under the old Operating Agreement

"shall continue their existing status under the Operating Agreement during the extended term of such Agreement" (Plan Div. II, Paragraph 7; Div. III, Paragraph 7; $2,485,482.58 on December 31, 1939).

The Plan purports to make no change in Peoria & Eastern's $4,000,000 of 4% non-cumulative income bonds due April 1, 1990, which by their terms are subordinate to the First Consolidated Mortgage Bonds and also to the operating agreement. The Plan leaves unaffected the outstanding capital stock totaling $9,999,200.

(d) Valuation and Indebtedness

The basic valuation by the Interstate Commerce Commission of the Peoria & Eastern's land, road and equipment, with net additions and betterments to December 31, 1939, is $10,836,396.86 (as against book value of $20,616,896.01) (Finding 28, Exhibit 35).

There is no evidence of value except said valuation of the Interstate Commerce Commission. Using that as a basis, the situation created by the "Proposed Plan of Adjustment of Peoria & Eastern" is as follows (it being remembered that the Plan proposes to pay off the $5,000,000 purchase money lien upon the Springfield Division and reduce the liabilities by $5,000,000) (Ex. 35):

ASSETS

Road and equipment	$10,836,396.86
Miscellaneous physical property, deferred assets and miscellaneous investments in affiliated companies	210,439.83
Unadjusted debits, equipment retirement and depreciation accounts	1,290,296.84
Total Assets	$12,337,133.53

LIABILITIES

First Mortgage Bonds to be outstanding upon consummation of Plan	$4,722,300.00
Junior Income Bonds	4,000,000.00
Non-negotiable debt to New York Central and Big Four	2,485,482.58
Capital Stock	9,999,200.00
Total Liabilities	$21,206,982.58

This would show a balance sheet deficit for Peoria & Eastern, after the adjustments contemplated by the Plan, of $8,869,849.05.

(e) Earnings

In considering Peoria & Eastern's income, it must be remembered that the $200,000 annually heretofore received on the $5,000,000 purchase money lien upon the Springfield Division, which lien is to be paid off under the Plan, must not be included. As so adjusted, the available net earnings for the past ten years have been as follows (cents omitted) (Ex. 33½):

1930	$ 69,287
1931	34,047
1932 (Deficit)	*32,593*
1933	225,586
1934	170,233
1935	234,897
1936	452,115
1937	166,887
1938	129,987
1939	252,566.

The average of such earnings is $170,301.20. Under the Plan, the interest requirements upon the obligations presently to be outstanding are as follows:

First Mortgage Bonds	$188,892.00
Non-negotiable debt to New York Central and Big Four, principal sum $1,814,-956.24 at 6% interest, cumulative, if earned	108,897.37
Income Bonds, 4%, non-cumulative, if earned	160,000.00
Total income requirements	$457,789.37

before anything can be paid on the principal of the over-due First Consolidated Mortgage Bonds.

(f) Peoria & Eastern as an Instrumentality—

Peoria & Eastern is a mere instrumentality of, first, the Big Four, and, now, the New York Central. "By reason of its ownership of a majority of the stock of the petitioner [Peoria & Eastern] the Big Four and/or the New York Central have completely dominated and controlled the affairs and business of the petitioner" and "enjoyed unrestricted control over the solicitation of traffic on petitioner's property" (Findings 18, 22).

The balance sheets of Peoria & Eastern for the last ten years (Ex. 35) indicate that it has never had any cash, bank account or quick assets, even in the year 1936, when it earned $182,558 net over fixed charges. Practically all directors are officers or employees of the New York Central (Exs. D, E and F).

The proposed twenty years' extension of the Operating Agreement lacks any evidence of negotiations with anyone on behalf of Peoria & Eastern, either as to the term or conditions of renewal.

This agreement proposes to continue as a charge against future earnings, accumulated operating deficits of the past fifty years with 6% interest, and future operating deficits cumulative, also at 6% interest. (Plan, pp. 18, 23; Extension of Operating Agreement, p. 2, par. First.)

The total traffic revenue over the lines of Peoria & Eastern for the year ended June 30, 1939, was $4,412,348, of which New York Central received $2,193,162, and Peoria & Eastern, $2,219,186 (I. C. C. Report, p. 19). There is no evidence of any bargaining as to the division of freight rates.*

Likewise, except for a brief period, there was no outsider to supervise the accounts. In 1919, after an investigation, the Big Four reduced its charges against Peoria & Eastern from $324,286.02 to $24,912.65; and between 1925 and 1932, while a representative of the income bondholders was upon the Board, charges were reversed against Peoria & Eastern to the extent of $755,629 (Ex. Y). During the twenty years from December 31, 1919 to December 31, 1939, these charges mounted from $24,912.65 to $2,485,482.58 (Ex. I).

(g) The Equipment Accounts

By the Operating Agreement, the Big Four (and New York Central as its successor) agreed to provide and furnish, keep and maintain, at its own cost and expense, all rolling stock and equipment in good working order, and restore or renew all parts thereof as may be necessary to that end (Paragraph First). In lieu thereof, New York Central set up against itself an "Equipment Retirement Account", which has averaged for the past five years $516,225 (Ex. 35). The Plan (Paragraph 6, p. 23) provides that Big Four will replace equipment "which has been retired and not replaced, or has become unserviceable for further use, with suitable equipment * * *", equal

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* The brief below on behalf of income bondholders states at page 35:

> "In the instant case, to employ the language of the Examiner of the Commission before whom the proceedings were heard, 'There was no one to bargain with' ".

to the $516,837.38 appearing in that account as of December 31, 1939.

The Interstate Commerce Commission report shows that this fund "of approximately $515,000" will restore to Peoria & Eastern 400 cars at an annual saving of $106,526 on a *per diem* basis (pp. 17-18). The actual *per diem* cost for equipment rents for 1939 was $142,217.36, as against the estimated cost of $35,657 which would follow the above restoration of cars (Exs. 33½, 41).

This annual loss of $106,000 was partially palliated by the charge of 6% upon the equipment retirement account which the New York Central charged against itself, which would amount on the average to $30,973.50 per year. But the New York Central apparently offset it against an equivalent of interest on its advances; which advances and interest thereon, however, it could not obtain except from surplus profits of which there were none, and which in no event could it recoup as against the First Consolidated Mortgage Bondholders (Supplement of February 22, 1890, to Operating Agreement (Ex. 27) which latter was assigned to the Mortgage Trustee by Indenture dated March 25, 1890, Findings 13, 27).

The Plan states that the New York Central "is holding for the benefit of the Peoria and Eastern" both the above equipment retirement account and $768,710.44 in an equipment depreciation account" (p. 18; $773,459.46 on Dec. 31, 1939, Ex. 35). The equipment depreciation account is not disposed of by the Plan. That account for the past five years has averaged $635,843.74, and if only a part thereof had been used to restore the depreciated rolling stock, there would not at any time throughout the ten-year period have been any net equipment rents. The total of such rents for the ten-year period constituted a direct loss which was proximately caused by the violation of the operating agreement and the mortgage indenture and amounted to $1,316,077.78 (Exs. 33½ and 35).

(h) Equipment under the First Consolidated Mortgage

The granting clause of the First Consolidated Mortgage Indenture of February 22, 1890 (Ex. 20, p. 6), covers "all engines, cars, coaches and other rolling stock", with a provision in Paragraph Eighth, that the trustees under the mortgage may release property no longer needed and require the proceeds to be applied like insurance money; that is to say (p. 13):

> "All proceeds of such insurance to be paid over to and held by said Central Trust Company of New York as additional security until the same shall be applied by direction of the Railway Company either in restoring or renewing the parts of the mortgaged premises so injured or destroyed, or in improvements thereof * * *."

As to the interest thereon, the earning statements (Exhibit 33½) do not indicate any such payment. On the contrary, the New York Central charged interest on net intercompany account indicating that the interest on the equipment account was merely offset against the claimed interest on the "advances" account (Finding 27). This was not permissible because

(a) such advances were to be repayable only from net profits and there were no net profits any year for the past ten years except 1936 (Exs. 33½, 35); and

(b) by virtue of the "Supplement to Operating Agreement", also dated February 22, 1890, the provision permitting the Big Four to recoup for its advances under its guarantee of interest on the bonded indebtedness was to be effective against all parties "other than the holders of the First Consolidated Mortgage Bonds and the Trustees of the mortgage securing the same" (Ex. 27).

Apparently, the New York Central has sought to avoid this provision of the "Supplement to Operating Agree-

ment" by charging betterments to a separate account totaling $1,806,493.18 plus $522,517.24 interest thereon (Finding No. 27) and not treating betterments as part of the expenses of operation and maintenance; although by Paragraph Third of the Operating Agreement, expenses of operation and maintenance are defined to include "repairs, renewals and reasonable betterments".

It is significant that the "Supplement to Operating Agreement" is dropped completely in the scheme under the Plan of Adjustment, and is not part of the "Extension of the Term of the Operating Agreement" annexed to the Plan and petition.

(i) Diversion of the mortgaged estate and waste

As aforesaid, the $1,290,296.84 in the equipment retirement and depreciation accounts is the product of the mortgaged equipment and constitutes additional security therefor. The Plan does not utilize said moneys for the liquidation of the mortgage bonds nor of prior liens. Instead the Plan takes $1,121,000 from the $5,000,000 produced by the purchase money lien upon the Springfield Division to pay $846,000 to a prior lienor and to pay to Securities Corporation of the New York Central, $275,000 more than the *pro rata* on its bonds held in pledge.

It would appear that on default day, April 1, 1940, the $5,000,000 purchase money lien and the $1,290,296.84 equipment fund were available exclusively for the First Consolidated Mortgage Bondholders, a total of $6,290,296.84, instead of the $3,879,000 distributed to them under the Plan —an apparent diversion from the mortgage estate of $2,410,000, equivalent to $270 per outstanding bond. After such diversion, the cash payments to the bondholders under the Plan are $450 per $1,000 bond.

In addition, the 6% interest on the equipment retirement and depreciation fund, attempted to be offset against the advances of New York Central, should have been avail-

able to the mortgage trustee upon any proper accounting; or in the alternative the loss of $1,316,077 resulting from failure to properly maintain the rolling stock should have been available.

The court below declined to refer the case to a special master or to pass upon the so-called inter-company accounts, leaving undetermined for some future proceedings the questions involved in such accounts (Decree, sec. 24; opinion, appendix A, pp. 29-30), although the validity and enforcibility thereof would seem to lie at the threshold of the proceeding; involving the two-fold questions as to what was available for the payment of the matured bonds, and whether there had been such diversion or such use by the parent company of Peoria & Eastern as to make it inequitable to continue the operating agreement in its favor.

(j) Approval of Plan

The District Court confirmed the Plan except that it permitted the income bondholders to have one representative on the Board, but declined a similar request by the First Mortgage Bondholders, and "reserved for future determination" the inter-company accounts (Decree, Secs. 24, 25).

The plan had been approved by the Interstate Commerce Commission and by over 75% of the Mortgage Bondholders. By the Railroad Adjustments Act, the Court must "scrutinize the facts independently of the extent of acceptances" and of the "findings" of said Commission (§ 725 [3]).

The Assignments of Error

The District Court erred in decreeing that the Plan should be approved; specifying:

(a) The Peoria & Eastern had insufficient assets and earnings to support its capital structure, hence its fi-

nancial difficulties are not "temporary only", but fundamental. This requires, not a short term arrangement under Chapter XV, but a "financial reorganization of the character provided for under" Section 77 of the Bankruptcy Act (Railroad Adjustments Act, § 710 (2) (a), (b)).

(b) Such deficiency of capital and earnings required the elimination or complete subordination of junior debts and stockholders—particularly of New York Central as parent and operating corporation—so as to free future earnings for the payment not only of interest but also of amortization or sinking fund upon the overdue first mortgage debt. Fear lest rejection of the Plan might bring worse results, inducing high percentage of bondholders' consents (Opinion, pp. 33-35), should not coerce the Court to declare as "fair and equitable" what has been denounced uniformly as inequitable (*Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106, 112-113, 122-124).

(c) There is no finding of "inability to meet its debts matured or about to mature" and no finding of any efforts to obtain funds in the capital markets or from Reconstruction Finance Corporation or from New York Central in reparation of asserted diversion and waste of assets [§ 710 (2) (b)].

(d) The Plan forces an extension of twenty years upon bonded debt, due to insufficient assets and earnings. This does not satisfy the requirement that "inability to *meet* its debts" will be "temporary" only. Debts are not met with only temporary delay by avoiding them completely for twenty years, or maybe indefinitely if railroad revenues and values continue their downward trend. A twenty year moratorium is not, in fact or in law, the equivalent of reasonably prompt payment. (§ 710 (2) (b); In the matter of Flour Mills of America, S. E. C. release No. 22, April 11, 1940).

(e) The Plan is not "fair and equitable as an adjustment" and does not "conform to the law of the land regarding the participation of the various classes of creditors and stockholders [§ 725 (c)]. The Plan

provides for payment of principal and interest upon the advances of New York Central (the parent and operating corporation) and preserves its stock and management control with their incidental advantages and emoluments—all, without paying or making provision for the payment or amortization of the matured mortgage debt which, by its terms has priority. (*Louisville Trust Co.* v. *Louisville, N. A. & C. Ry. Co.,* 174 U. S. 674 (Monon case); "the *Boyd* case, its antecedents and its successors", including *Case* v. *Los Angeles Lumber Co.,* 308 U. S. at 118, 120).

(f) The Plan should not have been approved and no equitable relief against strict foreclosure should have been granted where charges of diversion of assets and earnings are made against the parent corporation and not determined by the Court but left open for future determination. Thereby, the parent corporation gets full protection for its dominating position and its investment, without any determination of whether it is barred from such equitable relief by its own inequity (*Monon* case, *supra; Farmers Loan & Trust Co.* v. *N. Y. & Northern,* 150 N. Y. 410).

(g) The Plan should not have been approved because it recognized New York Central as a creditor in competition with prior lienor, whereas Peoria & Eastern was its mere instrumentality whose affairs it dominated and whose assets and accounts it confused with its own; so that its advances should have been treated as capital contributions.

(h) The mortgagee bondholders are entitled to their money or the property. If junior interests are to be saved from strict foreclosure, the mortgagee bondholders must be secured in their lien upon the property and its earnings for the repayment of their debt with interest. A sinking fund payable out of earnings should be established at least up to the present estimated amount of such earnings; leaving for the junior interests any additional earnings which their industry, fidelity and ability may create. The estimated net earnings presently available based upon 1939 gross revenue are $304,727 with increases expected for 1940

(Finding 24). $306,950 for the first year should be allocated to the mortgage bondholders, of which $188,892 should go for fixed interest at 4% for the first year and lesser amounts as bonds are retired through the sinking fund. This would require a sinking fund of 2½%, cumulative, payable, if earned, which would absorb $118,058 of such earnings in priority to the $108,897.37 which the New York Central absorbs under the Plan (*ante,* page 10). If earnings continue, this would retire half of the bonds at maturity, or a much larger percentage so long as the modified bonds continue at low levels. (Present market price about 46.) In this manner, the average maturity of the extension is reduced by at least a quarter, and the lien of the mortgage bondholder is recognized for the payment not only of interest but also for the repayment of the overdue principal. To safeguard the proper application of earnings, the mortgage bondholders should be entitled to a representative upon the Board. The Plan should not have been approved without incorporating these provisions as a modification under § 725 (2).

(i) The prior lien of the mortgage bondholders upon the equipment should also have been recognized by modification which would require the utilization of the $768,710.44 in the equipment depreciation account as an additional sinking fund to reduce the bonded debt. This, too, would reduce the average maturity of the extension and reduce fixed interest; and, at prevailing low quotations, would enormously benefit not only the mortgage bondholders, but also the junior creditors by so large a reduction of the bonded debt. The Plan should not have been approved without incorporating this provision as a modification under § 725 (2).

(j) The Plan should not have been approved without a prior accounting by the Big Four and the New York Central as to the charges of diversion and waste of assets appearing *prima facie* of record.

The foregoing subdivisions lettered (a) to (j), are intended to be assigned as errors individually and also in combination with other subdivisions.

Reasons for Allowance of the Writ

1. The decree herein is in conflict with the applicable decisions of this Court, in that it secures for the equity owner priority of payment of interest and principal upon its advances without providing for payment of the overdue mortgage debt which has seniority; particularly where, as here, there are not enough assets and earnings to support the capital structure established by the Plan. (*Case* v. *Los Angeles Lumber Co.*, 308 U. S. 106; *Securities and Exchange Commission* v. *U. S. Realty Improvement Co.*, 84 L. Ed. 966.)

2. The decree herein is in conflict with the applicable decisions of this Court, in that it secures for the equity owner full recognition for its dominating position and investment and full equitable relief against strict foreclosure where charges of inequitable conduct through diversion of assets and earnings are based upon record facts but left undetermined. (*Louisville Trust Co.* v. *Louisville, N. A. & C. Ry. Co.*, 174 U. S. 674.)

3. The decree herein decides an important question of Federal law, which has not been, but should be, settled by this Court; namely, whether the Railroad Adjustments Act contemplates anything more than a reasonable moratorium to meet a temporary emergency, leaving long term adjustments and basic changes required by deficits in assets or earnings to the more careful scrutiny and determination pursuant to Section 77 of the Bankruptcy Act.

4. The decree herein is in conflict with applicable decisions in this Court, in that it permits a parent corporation which is within the "Instrumentality Rule" to compete as to its advances with outside creditors without subordinating its claim; where, as here, there has been com-

plete domination of the subsidiary and a confusion of its assets, transactions and accounts. *Taylor* v. *Standard Gas & Electric Co.*, 306 U. S. 307; *Pepper* v. *Litton*, 84 L. Ed. 160.

5. The District Court has departed from the usual course of judicial proceedings in reorganization cases, in that it assumed there was no alternative between approving the Plan and ordering a strict foreclosure; whereas, the accepted practice is for the court to suggest modifications of the Plan in the interest of fairness and legality; which modifications, in line with subdivisions (h) and (i) aforesaid, should provide for the application of the equipment depreciation account of $768,710 and the annual application of $118,058 of estimated surplus earnings for sinking fund purposes. This would recognize the mortgage bondholders' lien upon the property and its earnings, would reduce the average maturity of the extension from twenty years to less than ten years, and would increasingly benefit junior creditors through the annual decline of prior liens and prior interest charges.

6. Not to allow this appeal would depart from the usual course of judicial proceedings, since there was no Special Master whose findings might have been reviewed by the Special Court, and, therefore, matters of such weight and importance would rest upon the single decision of the trial court, without any opportunity for a considered review of their decision.

WHEREFORE, YOUR PETITIONERS PRAY for the allowance of a writ of certiorari to the District Court of the United States for the Southern District of New York in this cause, there entitled "In the Matter of The Peoria and Eastern Railway Company, Petitioner", that said cause may be reviewed and determined by this Court and that

the decree of said District Court may be reversed and set aside; and for such further relief and remedy as this Court may deem meet and proper.

Dated: New York, N. Y.,
September 26, 1940.

DONALD N. GILBERT, HAROLD C. YEAGER
and GEORGE A. CAREY, Petitioners,

By SCRIBNER & MILLER,
ALFRED E. SMITH, JR.,
Solicitors of Petitioners.

MARK HYMAN,
Counsel for Petitioners.